



Oklahoma Economic Report™

News and analysis of Oklahoma's economy

A publication of the Office of the State Treasurer • Treasurer Ken Miller, Ph.D.

Pension reform road maps

The states are often referred to as laboratories for policy and reforms. Across the nation, states struggling with pension debts and deficits are pursuing structural reforms to public worker benefit plans. As Oklahoma attempts to solve its pension problem, it may find a road map in reforms enacted by other states.

While the approaches differ, concerns raised in states considering changes to public pensions are fairly consistent: whether proposals will reduce benefits for current employees; how the state will meet current pension commitments when new workers contribute to a different system; how cost-of-living

adjustments (COLAs) can be funded; and, whether a new benefit structure will offer enough security for future public workers.

With very few exceptions, states adopting or considering reforms have not suggested changes to benefits promised to workers enrolled in the state's current plan, nor any retiree. Such is the case in Oklahoma, where policymakers have proposed no changes to the benefits promised to current workers or retirees.

Contributions

Concerns that the loss of new contributions to the defined benefit plan will harm workers under the current system can be met by maintaining dedicated funding levels. With this commitment, and employers contributing to a less costly plan, the state can dedicate a portion of the "savings" toward the unfunded liabilities of the closed plan. Additionally, once past obligations are met, the state can use the savings from the less-costly benefit plan to grant COLAs or adjust employee compensation.

COLAs

In recent years Oklahoma stopped granting unfunded cost of living adjustments, but statute is unclear on what constitutes funding. For example,

could an individual plan grant a COLA if the plan is fully funded and investment earnings are sufficient to absorb the cost?

Kentucky, whose pension reform

proposals have recently been adopted by both legislative bodies and await action from the governor, also require that any COLA be pre-funded by the Legislature.

Rhode Island, which enacted what has been called the boldest pension reform in the nation, suspended COLAs for all public workers until the collective funded status of all the plans exceeds 80 percent. However, even under the suspension the state allows one COLA every five years, based on the plan's five-year average investment return.

Retirement security

Some current public workers, whose benefits would be unaffected by any reforms proposed in Oklahoma, have expressed concern for the workforce that replaces them in the future. They worry that a reduction in benefits could discourage well-qualified workers from entering public service. To address this concern, many states are retaining attractive public worker benefits, even after adopting reforms, by assuming

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“As Oklahoma attempts to solve its pension problem, it may find a road map in reforms enacted in other states.”

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Treasurer's Commentary By Ken Miller, Ph.D.

Capitol complexities

No matter how many times one visits our nation's capital, seeing the grand institutions and monuments always instills a strong sense of national pride and purpose. Whether walking through the halls of Congress or past Lincoln and Jefferson, a citizen cannot help but feel fantastically American.

Today, scaffolding surrounds the Washington Monument and the Supreme Court: a testament to the importance of maintaining a nation's symbols of democracy for functional and symbolic purposes. Yet, seeing this recently made me wonder if their elaborate construction would still be possible today or considered just another example of wasteful spending.

Oklahoma too has grand institutions with the State Capitol building at the fore. Governor Frank Keating determinedly pushed past many critics to complete this architectural achievement with a magnificent dome. Today, it is a source of much pride and critics are hard to find.

Now this nearly 100-year-old structure and others within the capitol complex are in need of major repair. Though this Legislature inherited the problem, its members must be the ones to solve it.

While the need for action is recognized, the debate centers on the method of finance. Two camps currently exist: cash and bonds.

The House seems to favor cash, which of course is always preferable when possible. Yet, even with \$214 million in additional revenue, it is unlikely the Legislature will find an estimated \$150 million-plus for capitol complex repairs due to the

“Cutting the income tax and financing repairs to the capitol complex can both be responsibly accomplished this session.”

challenges of replacing \$400 million in non-recurring revenue and dealing with \$1.2 billion in new agency requests. A cost-benefit analysis shows investment earnings lost by tapping the Rainy Day Fund would outweigh the interest expense saved. Thus, an incremental approach as funds become available remains the only viable cash option.



The Senate appears to favor bonds. Debt, the largest source of business funding, is advisable only when the balance sheet permits, a payment source is identified and the return on investment (ROI) outweighs the opportunity cost -- the market rate of interest and the inflationary cost of delay.

Bond backers argue Oklahoma's tax-supported debt is low at 1.5 percent debt-to-GDP and is half the 50-state average. With historically low nominal interest rates nearly equal to current inflation rates, this camp suggests the state can easily earn a positive ROI because the real interest rate is zero and the cost of delay is eliminated. Having identified a non-tax source for debt service, they contend bonds currently provide the most cost-effective method of finance given budget constraints. *Ceteris paribus*, a financial analyst would agree.

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Commentary

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However, given the current political environment and billions in unfunded pension liabilities, the problem is much more complex than a simple financial equation. While some argue against debt for ideological reasons, others take a practical but broader view of debt, believing the pension problem should be addressed before additional bonds are issued; a point difficult to argue against.

Both chambers have already endorsed at least a quarter-point reduction in the income tax. Proponents of the cut, like

me, believe that increasing the profit incentive can reap returns in the long-run. Critics contend that cutting taxes by \$120 million on an annual basis while simultaneously issuing bonds by a similar amount is akin to bonding a tax cut. Dual support of a tax cut provides an alternative option if, like last year, compromise cannot be reached between the two camps.

Cutting the income tax and financing repairs to the capitol complex can both be responsibly accomplished this session. The Legislature could pass a bill to lower the income tax, but move

the effective date forward by twelve months. By dedicating the revenue that would have been lost with earlier implementation, the capital project could be financed without debt or costly delay. This approach may appeal to those who want to address Capitol repairs without debt but also want to lower taxes on Oklahoma families.

Regardless of the method chosen, citizens can rest assured this Legislature will resist inaction and restore our capitol complex to its original glory. And for that we can all feel fantastically Oklahoman.

Road map

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some risk on behalf of the employee.

Most private sector retirement plans consist of a 401(k) account in which employee contributions are invested, many times with an employer match. The funds grow, or shrink, depending on the investment strategy and market performance. The employer assumes no risk or responsibility that the employee has sufficient funds for retirement.

While some states are pursuing new pension models that more closely resemble a 401(k), or defined contribution framework, other states are finding a compromise in offering a hybrid plan – often referred to as a “cash-balance” option.

Under this model, an employer makes defined contributions on behalf of the employee to an individually owned account. Most states require the

employee also contribute, others tie the state’s contribution to the employee’s. What sets cash-balance plans apart is that the state manages the investments and shares the investment risk with the employee, often guaranteeing a minimum rate of return. The plans also offer workers annuities, or lifetime income in the form of a fixed monthly

benefit, as a payment option upon retirement.

Nearly half the states have already moved away from traditional defined benefit plans and many, including Oklahoma, are actively considering transitioning to a more sustainable

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Policy Objectives for Funding Public Pensions

(As recommended by a national pension funding task force)

- Have a pension funding policy that is based on actuarially determined contributions.
- Build funding discipline into the policy to ensure promised benefits can be paid.
- Maintain intergenerational equity so the cost of employee benefits is paid by the generation of taxpayers who receives services.
- Make employer costs a consistent percentage of payroll.
- Require clear reporting to show how and when pension plans will be fully funded.

Recommendations were the result of a task force formed by seven national associations representing state and local governments and the Government Finance Officers Association.

Opinions and positions cited in the *Oklahoma Economic Report™* are not necessarily those of Oklahoma State Treasurer Ken Miller or his staff, with the exception of the *Treasurer’s Commentary*, which of course, is the viewpoint of the treasurer.



FY-14 Budget Requests

Agency	Request
TOP 20	
Historical Society	+352.1%
Conservation Commission	+197.3%
Will Rogers Memorial	+173.8%
OCAST	+162.2%
J.M. Davis Memorial	+92.6%
Physician Manpower Training	+92.5%
Oklahoma Scenic Rivers	+85.7%
District Courts	+73.1%
Horse Racing Commission	+72.9%
OBND	+65.3%
State Auditor and Inspector	+56.6%
OETA	+53.2%
State Ethics Commission	+51.8%
DMHSAS	+46.2%
Merit Protection Commission	+44.2%
Medical Examiner	+39.9%
Rehabilitative Services	+34.4%
Attorney General	+31.1%
Human Services	+30.6%
School of Science and Math	+30.6%
BOTTOM 20	
Teacher Preparation	0.0%
State Bond Advisor	0.0%
State Election Board	0.0%
Civil Emergency Management	0.0%
Governor	0.0%
House of Representatives	0.0%
Legislative Service Bureau	0.0%
Lt. Governor	0.0%
Senate	0.0%
Space Industry Development	0.0%
Oklahoma Tax Commission	0.0%
Department of Transportation	0.0%
Commission on Children & Youth	0.0%
Office of Disability Concerns	0.0%
J.D. McCarty Center	0.0%
Department of Commerce	0.0%
Department of Consumer Credit	0.0%
Insurance Commissioner	0.0%
Tourism and Recreation	0.0%
Water Resources Board	0.0%
CLO* nonappropriated	-5.0%
Oklahoma State Treasurer	-5.1%

Source: Senate Budget Brief, 2-28-13

Q & A with Senate Appropriations Chair Clark Jolley

OER: The Executive Budget eliminated use of one-time sources of revenue to fund ongoing operations. Do you pursue this approach?

CJ: Yes, the Governor and I are in absolute agreement on that point. We must reduce the amount of one-time sources for recurring expenditures. However, I don't believe we can implement this reform in just one year. My suggestion is that we do this over the next two fiscal years. If we cut our reliance in half each year, we should be able to meet our shared goal of reducing use of one-time revenues while also having some resources to restore funding to common education and public safety and pay for reforms at the Department of Human Services.

OER: Should state agencies expect funding to return to the amounts seen prior to the last recession?

CJ: No and yes, it depends on the agency. Most state agencies have experienced up to a 24 percent cut in spending. As their health insurance expenses continue to rise but their funding does not, we are effectively continuing to cut their program funding because their personnel costs keep rising. Some can absorb it and others cannot. We have to examine funding needs on outcomes and performances, not from a "more or less" standpoint or an across-the-board mentality. Limited resources require that we be strategic in our spending and invest in areas of highest return. While Oklahoma is among the lower-spending states, we should always strive to be more efficient.

OER: You mention Oklahoma is among the lower-spending states, yet some say state spending in Oklahoma is at an all-time high. Your response?

CJ: State spending is not at an all-time high. That claim is based not on state spending, but total government spending from all sources – federal, local and state. Oklahoma's federal tax dollars are being returned to the state at a higher rate than ever before. Because of the efforts of people like Sen. Jim Inhofe and Secretary of Transportation Gary Ridley, the federal government is spending more money on roads and bridges in Oklahoma than ever before. We have a tremendous number of federal jobs in Oklahoma with all the military bases and agencies such as the FAA having a significant presence here. However, the state portion of spending which legislators directly control is clearly lower than the all-time high. It should be noted that our state population is also at an all-time high and we continually experience inflation. The intent of the claim is to push for lower state spending. This is a departure from the idea that we should focus our efforts on restraining spending to growth in population plus inflation, which is a more realistic and prudent course.

OER: What is the likelihood of an income tax or sales tax cut this session?

CJ: Senate Republicans are committed to a tax cut this session. I predict it will result will be an income tax rate of 5 percent or just below. I suspect we will utilize growth revenue as the primary

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Jolley

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source for paying for the cut this next year. However, it shouldn't be lost that when we had a 7 percent tax rate, our state appropriations were around \$5 billion. Today, our tax rate is closer to 5 percent and our budget will be more than \$7 billion. Our tax revenues have only grown with the cuts. With the fifth highest state and local combined sales tax rate in the United States, Oklahoma could benefit from having a comprehensive discussion on lowering our sales tax rate by broadening the base.

OER: What are your budget priorities?

CJ: Understanding that state agencies have made \$1.2 billion in additional spending requests and the state only has \$214 million additional to allocate, there will be about a billion dollars of disappointment in the final product we pass this year. That being said, we have to make sure that the reforms enacted due to the lawsuit settlement at the Department of Human Services are funded appropriately. I'm committed to funding the reforms we have made in education. Our universities have needs and are attempting to raise the number of college graduates under Governor Fallin's Complete College America

agenda. Our District Attorneys and other public safety areas are a priority to me. We must also continue our dedication to mental health treatment and do our best to address the drought with greater conservation efforts.

OER: What are your thoughts on funding for Oklahoma's Capitol and infrastructure needs?

CJ: The Capitol is only one of a plethora of needs this state has for infrastructure. Speaker Shannon and I passed a bill a few years back to require an accounting of all state assets and he has really taken the lead in wanting to have a permanent fix to the lack of infrastructure investments. We have to look at making permanent fixes to ensure our facilities don't fall into disrepair. But our current infrastructure is so dangerous that immediate investment must be considered. The Capitol complex is a huge concern, with the Capitol literally falling down around us and the Jim Thorpe building almost unusable in its current state. We also have a Medical Examiner's facility that has to be built from scratch. There is a considerable amount to do with few options left to consider. We must do a better job of capital planning in the future.

Meet Senator Clark Jolley

Senator Clark Jolley was first elected to the Oklahoma Senate in 2004 and serves as the Chair of the full Appropriations Committee and Co-Chair of the Joint Appropriations and Budget Committee.

Jolley received Music Education and Political Science degrees from Oklahoma Baptist University before

graduating Law School at the University of Oklahoma.

Jolley serves on the Worship & Arts Staff at Henderson Hills Baptist Church in Edmond and teaches in the MBA Program at Oklahoma Christian University. He and his wife, Verlyne, have two children, Alex and Lauren, in Edmond public schools.

Road map

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retirement benefit. While these state laboratories have developed slightly different paths to better fiscal health, each can be instructive to policymakers seeking to craft the Oklahoma solution.

Recent action by states:

Kentucky

Last week, the Kentucky Legislature sent the Governor a pension reform bill that would enroll all future public workers in a hybrid 'cash-balance' benefit plan, which would manage employer and employee contributions with the state guaranteeing a minimum four-percent investment return annually. Upon retirement, workers under the cash-balance plan can elect to have their benefits converted to a monthly annuity. The plan leaves benefits for all current employees and retirees unchanged.

Louisiana

Legislation enacted last year requires all employees hired after July 1, 2013 to participate in a cash-balance plan that the governor described as containing the best features of defined benefit and defined contribution plans. The individual accounts receive the actuarial rate of return on investment but the state guarantees that the funds can never lose value.

Rhode Island

The Rhode Island Retirement Security Act of 2011 took effect July 1, 2012 and created a combination defined benefit plan that included the addition of a defined contribution plan. Reforms also raised retirement ages to levels that match the Social Security retirement age, and required cost-of-living adjustments be tied to the system's funding level and actual investment returns.



Gross receipts & General Revenue compared

The Treasurer's March 4 Gross Revenue report and the Office of Management and Enterprise Services' March 12 General Revenue Fund (GRF) report contain key differences.

February gross receipts totaled \$790.4 million, while the GRF received \$254.6 million or 32.2% of the total.

The percentage of monthly gross revenue going to the GRF varied from 32.2% to 57.3% during the past 12 months.

From February gross receipts, the GRF received:

- Personal income tax: 8%
- Corporate income tax: 15.5%
- Sales tax: 45.4%
- Gross production-Gas: 39.8%
- Gross production-Oil: 69.5%
- Motor vehicle tax: 25.5%
- Other sources: 32.3%

February GRF allocations were below the estimate by \$20.4 million or 7.4 percent. In January, collections exceeded the estimate by \$60.5 million or 11.7 percent.

For the month, insurance premium taxes totaled \$12.9 million.

Tribal gaming fees generated \$8.2 million during February.

Gross collections dip in February

Oklahoma revenue collections dipped slightly in February, the fifth such occurrence in the past year, State Treasurer Ken Miller said as he released the state's monthly gross receipts to the treasury report.

"As with last March, June, August and November, collections in February are lower than the same month of the prior year," Miller said. "This follows 24 consecutive months of collections beating the prior year."

Miller said economic growth continues, but at a more subdued pace.

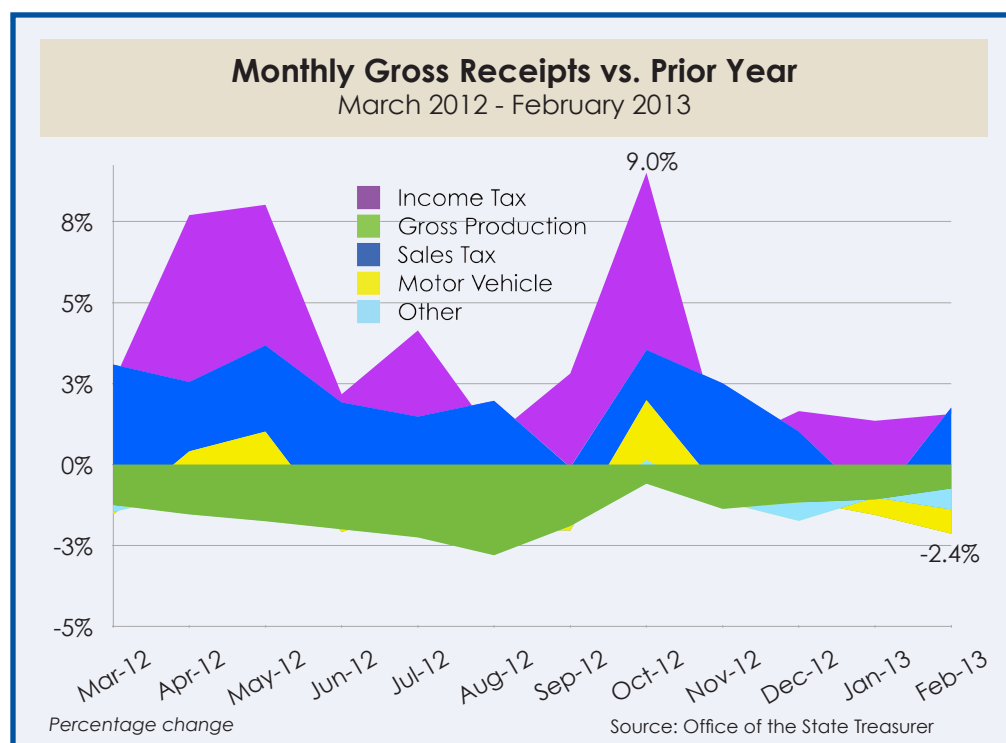
"Our average growth rate between March 2011 and February 2012 topped 10 percent," he said. "For the past 12 months, growth has averaged two percent."

The average rate of growth has gone from 10 percent to two percent in the past 12 months."

February gross collections were down by 2.4 percent, or almost \$20 million, from February of last year.

Oklahoma's two biggest sources of revenue, income tax and sales tax, both grew – income by 1.4 percent and sales by 3.9 percent.

Gross production, motor vehicle taxes and other sources were all reported as
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Report shows state unemployment rate drops in February

Oklahoma's seasonally-adjusted unemployment rate was set at 5.0 percent in February by the Employment Security Commission, down by 0.1 percentage point from January's rate.

Reports show state employment shrank by 310 jobs during the month, while the jobless number dropped by 1,370. Since February 2012, the state has added 19,410 jobs and the number of unemployed has fallen by 3,830.

The U.S. seasonally-adjusted jobless rate was set at 7.7 percent in February.

State Unemployment				
OKLAHOMA	Unemp. rate*	Labor force*	Employment*	Unemployment*
Feb '13	5.0%	1,817,060	1,726,070	90,990
Jan '13	5.1%	1,818,740	1,726,380	92,360
Dec '12	5.1%	1,816,630	1,723,540	93,090
Nov '12	5.1%	1,813,130	1,720,130	93,000
Oct '12	5.2%	1,810,920	1,716,320	94,600
Sep '12	5.2%	1,806,440	1,711,960	94,480
Feb '12	5.3%	1,797,650	1,702,830	94,830

* Data adjusted for seasonal factors

Source: OESC

Revenue

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lower than the prior year.

Monthly collections were marginally affected by the inclusion of a leap day last February.

Looking forward, Miller said the impact of a prolonged standoff in Washington over the federal budget and spending could eventually impact Oklahoma.

"The spillover effects of sequestration on household consumption and business

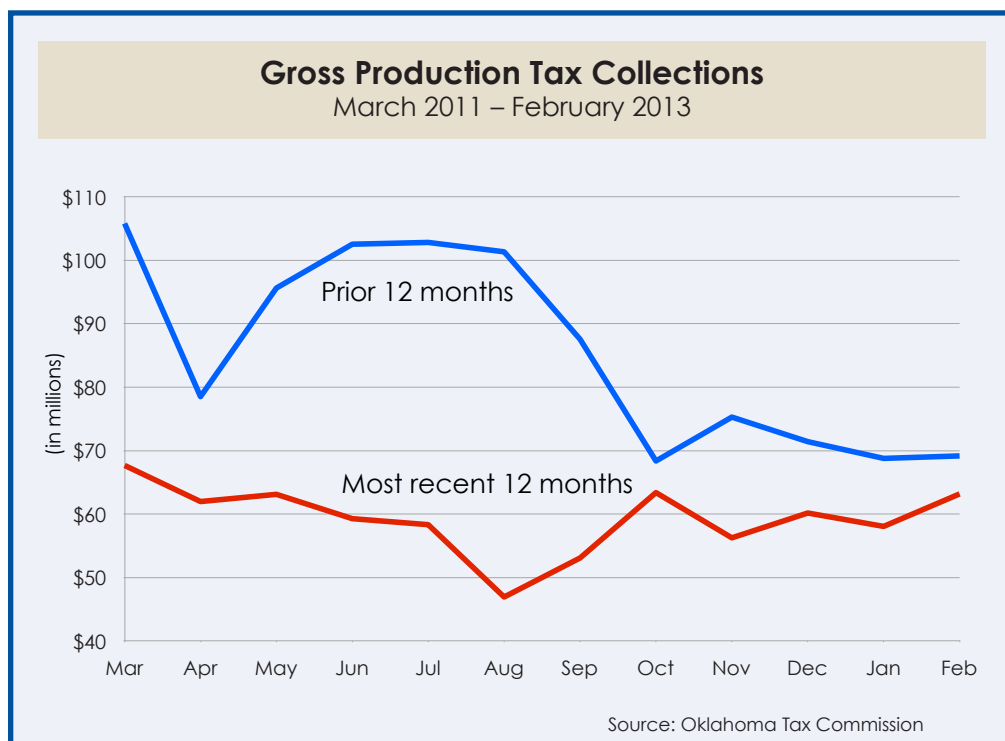
investment are a concern and could hamper future growth," he said.

"The sequester cuts, which are disproportionately weighted toward the military, could weaken both national security and our state's economy. Federal spending must be greatly reduced, but should be done strategically and include entitlement reform – the real spending problem in Washington."

Positive business conditions

The latest Business Conditions Index for Oklahoma report anticipates continued economic growth, though slightly slower than in January's report. The February survey shows Oklahoma with a rating of 52.5, compared to January's 53.8. Numbers above 50 indicate anticipated growth.

According to the survey, Oklahoma's economy is outperforming other states in the region as unemployment has dropped by two percentage points since the recovery started and the state labor force has expanded by almost 40,000 jobs.

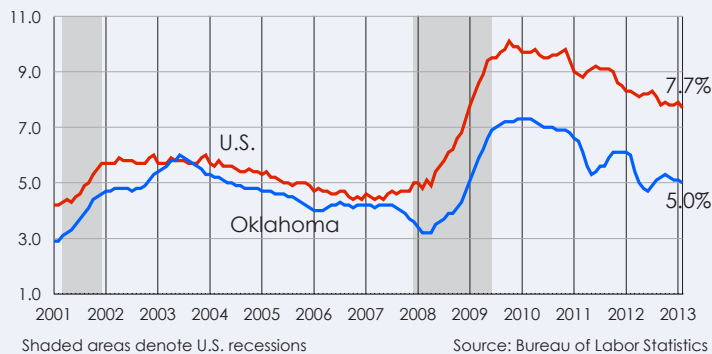




Economic Indicators

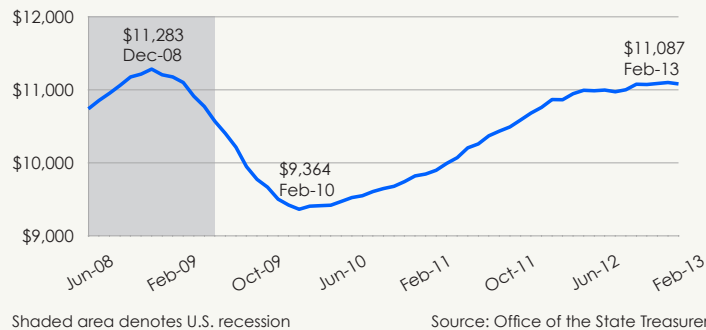
Unemployment Rate

January 2001 – February 2013

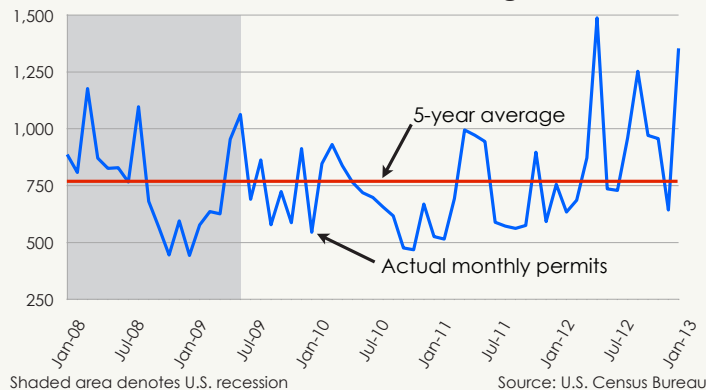


Oklahoma 12-Month Gross Receipts

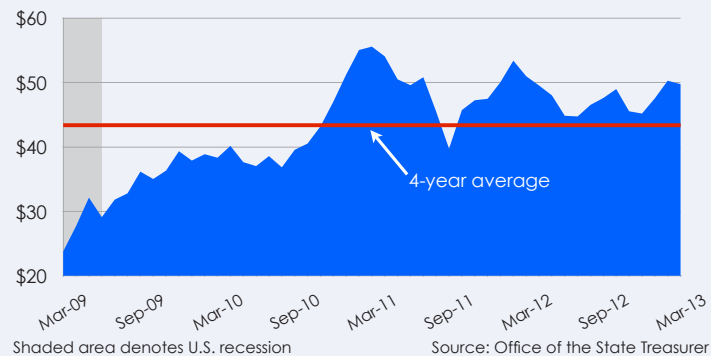
June 2008 - February 2013
(in millions)



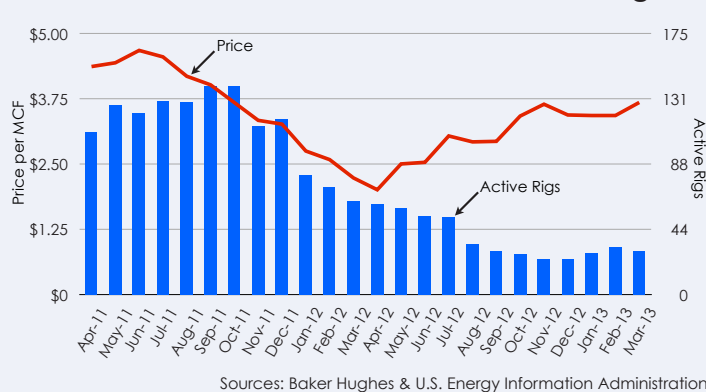
Oklahoma Residential Building Permits



Oklahoma Stock Index (Top 25 capitalized companies)



Oklahoma Natural Gas Prices & Active Rigs



Oklahoma Oil Prices & Active Rigs

